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SUBJECT: AMBASSADOR MEETS ENERGY MINISTER

SUMMARY

1. (SBU) Ambassador Polt met with new Minister of Energy Aleksandar Popovic on July 11 to review his plans for addressing Serbia's energy security. The minister, a vice president in Prime Minister Kostunica's Democratic Party of Serbia (DSS), said Serbia has no alternative to sourcing gas from the east but at the same time declared that his goal is to decrease dependence on the current single-source MOL pipeline. He pledged to have gas storage ready for winter 2008-2009 but declined to discuss how Srbijagas would find the money to fill the Banatski Dvor gas storage facility, mentioning only that the issue is linked to ongoing discussions of gas transit pipelines. Privatization of state oil monopoly NIS will proceed gradually, as planned by the previous government, but Popovic acknowledged that the goal is an eventual majority for the strategic partner. The meeting ended with a very frank discussion of Kosovo status. End summary.

2. (SBU) The Ambassador met with Minister of Energy Aleksandar Popovic for the first time in the latter's new capacity on June 20. Popovic, an assistant professor of chemistry at the University of Belgrade and a DSS vice president, was pleasant but guarded in discussing a series of energy issues, including Banatski Dvor gas storage, a gas pipeline to connect Serbia to Bulgaria's network, and privatization of state oil company Naftna Industrije Srbije (NIS). The Ambassador, who was accompanied by the Embassy's econ chief, opened the discussion by expressing understanding for the difficult task Popovic faces in pursuing energy security for Serbia; it is an important issue for the rest of Europe and the U.S., he added. Secure supply also was an issue for investors, the Ambassador noted, reminding Popovic that U.S. Steel was forced to cut production in January 2006 because of a natural gas shortage.

3. (SBU) Serbia is a small country that produces only 8 percent of its own gas, Popovic replied. Gas from the east is the only source, but Serbia must try to diversify to the maximum extent possible. Ambassador Polt noted that a Nis-Dmitrovgrad pipeline would provide Serbia with an alternative for gas supply. Popovic replied that this option is beyond Serbia's control; moving forward requires the agreement of Bulgaria and Jugorogas. (Note: Jugorogas, which is controlled by Gazprom, generally is believed to have an exclusive right to construct gas pipelines in Southern Serbia by way of Milosevic-era bilateral agreements.)

4. (SBU) At the same time, without such a pipeline, Serbia cannot get enough gas during winter, Popovic added, explaining that pressure in the MOL pipeline is not sufficient for central Serbia. Nor is the 12 million cubic meter daily capacity of the MOL pipeline enough as gasification expands in central Serbia.

5. (SBU) Ambassador Polt noted that gas storage would strengthen Serbia's energy security; however, Banatski Dvor would not be ready this winter, despite previous assurances. It's a simple story,

Popovic replied: Serbia needs only the money and 150 days during which to pump gas. The reservoir requires 100 million cubic meters of cushion gas. But Srbijagas lacks the money now, the Minister said, and the summer season, during which there is excess gas for filling the storage, soon will be over. Nevertheless, it will be ready next year, Popovic said: "I'll finish it or I'll resign."

¶16. (SBU) Privatization of state oil company NIS is another sensitive issue on the Ministry's plate, Ambassador Polt said, noting that the U.S. generally favors selling off the biggest possible stake, as quickly as possible. The Minister said that the Kostunica government would employ a more gradual approach similar to the strategy adopted - but not executed - by the previous government. The first stage would be sale of 25-37.5 percent to a strategic investor, who also would gain management control. The government's goal is to build NIS into a strong regional player, and this would require time, money and good management. On the one hand, Serbia would go slow in order to preserve a "national resource," Popovic said, but it would profit later by selling shares after the value of the company has been enhanced. The eventual goal is to sell off 50 percent plus one share, but privatization of a majority stake definitely would not happen under this government, Popovic said.

¶17. (SBU) Popovic added that he was strongly against privatizing power company EPS, which has a relatively stronger position. EPS would seek a strategic partner for co-investment in two, 700-MW coal-fired plants, but the government wants to build up EPS as a strong regional player. He explained that power is in deficit all over the region, creating opportunities for EPS. Although Serbia's power generating capacity has recovered from NATO bombing, Kosovo's power sector faces continuing production problems, he added. Serbia itself faces annual winter electricity deficits, and gas storage at Banatski Dvor could help by permitting an increase in winter power production based on natural gas.

¶18. (SBU) Ambassador Polt asked whether the current developments on Kosovo would influence the tenders that Serbia is planning. Popovic replied that the sell-off of a minority stake in NIS would be transparent. However, he added that Serbia is constrained by its geographic position, and by the fact that 95 percent of its gas comes from Russia.

¶19. (SBU) Turning to Kosovo, the Ambassador Polt sought Popovic's views on how possible additional time for Kosovo status engagement could be used to achieve progress. The Energy Minister, known for his strident and emotional views on Kosovo, replied that face to face negotiations led by a new mediator could be productive. Ahtisaari had not invested enough effort into the outcome. Talks should start with issues on which there is potential for agreement before moving into the tougher issues. "We are ready to offer a lot, but not independence," Popovic said.

¶10. (SBU) The Ambassador noted that an additional 120 days of talks would be a final opportunity for Belgrade to engage constructively with Pristina and the international community and ultimately to prepare for Kosovo's supervised independence. In that context, the Ambassador Polt asked Popovic how Serbia would propose to proceed.

¶11. (SBU) Some in Belgrade view a link between Kosovo and Euro-Atlantic integration as blackmail, Popovic replied. A premature solution now, without the possibility of something better, will hurt the region and Europe, although the U.S. will escape the consequences by virtue of its geographic position. More time is necessary; developments that were unthinkable in Bosnia now years ago now are politically possible with the passage of time, Popovic argued.

¶12. (SBU) Ambassador Polt argued that a hard-line reaction on the part of the Serbian government would damage almost exclusively Serbia's interests. Euro-Atlantic integration is a benefit for the Serbian people, as the road to prosperity. The Ambassador questioned whether Serbia believes it has other options for future success of its people?

¶13. (SBU) "We will do what we have to do," Popovic replied. "I have to say, as an American friend, that I am disappointed that America picked the wrong allies in the region." The U.S. choice of a strategic partner for the region would set the course for decades to

come, he added dramatically. Rejecting this emotional assertion, the Ambassador pointing out that NATO and other international support was the key guarantor of security and stability in Kosovo.

¶14. (SBU) The Ambassador said that after Kosovo status settlement, the U.S. will be ready to move on in its relationship with Serbia. He said he hoped that Serbia would be similarly able to move on.

POLT